

Fitch Examines How the Global Crisis Is Hitting Brazil

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According to a new report by Fitch Ratings, the global credit crisis has exposed some of the flaws of the decoupling arguments that were being advanced earlier this year about the correlation between the U.S. economy and emerging markets, including Brazil.

In the middle of September, several top Brazilian corporates started reporting that trade finance lines were disappearing as banks in the U.S. were working to preserve capital.

The market is also very tight for new local issuances, as the premium being paid by companies has increased to between 115% and 120% of the interbank rate (CDI), compared with 102%-105% for the same period in 2007; there is no guarantee, even at these prices, that debt can be successfully placed.

"The sharp devaluation of the Brazilian real has led high-profile corporates in Brazil such as Sadia, Aracruz and Votorantim to announce large mark-to-market losses on derivative positions," said Ricardo Carvalho, Senior Director at Fitch.

"This has led to much speculation about the size of the potential derivative problem within Brazil if the currency stays weak, and the fear that some corporates could become insolvent as they are forced to pay losses on derivative contracts."

"The derivative hedges of some of the companies in Brazil were clearly speculative. However, the majority of derivative positions of large issuers of corporate debt appear to have been designed to hedge either dollar revenues or debt obligations and do not have margin calls," said Joe Bormann, Managing Director. "The rapidly changing dynamics of the market could make some of these hedges less than perfect, resulting in material losses on "hedged" derivative positions."

Looking forward, the challenges for Brazilian corporates are numerous. A softening of domestic demand could result in GDP declining from about 5.0% in 2008 to below 3.0% in 2009. A combination of a sluggish economy, diminished access to credit, and a higher cost of credit, could pressure credit protection measures for companies in the airline, construction and retail industries, potentially leading to rating downgrades.

Beef exporters are expected to be pressured in the short term due to their high leverage, large working capital requirements, and reliance on pre-export trade financing.

Commodity producers in the metals and mining, and forest products sectors have seen a sharp decline in the price but

will see some improvement in their cost structures due to the devaluation of the real and should be able to withstand a prolonged downturn, given their strong balance sheets and position as low-cost producers globally.